VICTORIA COURT OF APPEAL, MELBOURNE, AUSTRALIA CASE NO [2007] VSCA 255 RENDERED IN NOVEMBER 2007 "The Oil Basins v BHP Billiton case"

Subject Matters:

Challenge due to:
a) manifest error on the face of the award
b) technical misconduct by members of the arbitral tribunal

Findings:

Under Victorian law, a domestic arbitral award may be successfully challenged if the arbitrators have not provided adequate reasons for each and every conclusion they reach.

Parties:

Claimant: Oil Basins Limited (Australia)
Respondent: BHP Billiton Limited (Australia)

Counsel:

For the Claimant: Mr. N J Young QC with Ms M Sloss SC and solicitor Arnold Bloch Leibler

For the Respondent: Mr. B W Walker SC with Mr. D J O'Callaghan SC and solicitor Middletons

Place of court proceedings:

Melbourne, Victoria, Australia

Seat of arbitration:

Melbourne, Victoria, Australia

Applicable law:

Commercial Arbitration Act 1984 (Vic) – applicable in Victorian domestic arbitration only

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THE DECISION

Acting judges: Buchanan Ja, Nettle Ja and Dodds-Streeton Ja

This is an appeal from a judgment given in the Commercial List of the Commercial and Equity Division. It concerns an interim arbitral award as to the application of an override royalty agreement to the Blackback oil field in Bass Strait ('the Royalty Agreement'). The judge set aside the award for error of law on the face of the award and for technical misconduct constituted by the inadequacy of the majority arbitrators' reasons and their failure to deal with relevant evidence and significant submissions.

The facts

As appears from the interim award, the Royalty Agreement was made between the late Dr Lewis Weeks, a renowned United States based geologist with particular skill and experience in petroleum exploration, and The Broken Hill Proprietary Company Limited ('BHP'). Early in 1960, BHP engaged Dr Weeks to evaluate petroleum prospects in the Sydney Basin in New South Wales where BHP held permits. After Dr Weeks travelled to Australia to examine the data and the relevant areas, he advised against the Sydney Basin and BHP subsequently surrendered all oil permits for that area. Before leaving Australia, however, Dr Weeks had further discussions with BHP's technical staff which culminated in BHP applying for, and becoming the holder of, three Petroleum Exploration Permits issued under the *Petroleum Act 1958* (Vic) and one Exploration Licence issued under the *Mining Act 1929* (Tas), with a view to BHP searching for oil mainly under the Bass Strait sea bed. To assist BHP in that endeavour, Dr Weeks also agreed to BHP's request that he act as its geological adviser in respect of its three applications for permit, namely, applications 38, 39 and 40 and, in accordance with that arrangement, Dr Weeks continued in his consultancy role until his death in 1977.

Petroleum Exploration Permit No.38 ('PEP 38') was granted to BHP on 23 June 1960. Under PEP 38, and pursuant to section 67 of the *Petroleum Act 1958* (Vic), BHP was granted the exclusive right to explore for petroleum (and for no other purpose) within the area covered by the permit for a period of two years from 1 April 1960. The permit could be extended for a further period(s) of 12 months at the discretion of the Minister. By letter dated 22 June 1960, Dr Weeks informed BHP that, in his view, '*[t]he most important areas*' he had recommended to BHP were those '*covered by the Victorian application*', he having '*long believed … that the Mesozoic-Tertiaries of the Bass Strait and neighbouring coastal belt offer the best opportunities for oil in Australia*'.

He advised BHP that it '*should seek to strengthen [its] position in the region when and wherever possible*'.[1]

Later in 1960, BHP and Dr. Weeks' nominee, Oil Basins Incorporated ('OBI'), which was the appellant's predecessor in title, entered into separate royalty agreements in respect of each of the areas covered by PEP's 38, 39 and 40 and Exploration Licence 1/60. BHP and Dr Weeks also entered into a Consultancy Agreement ('the Consultancy Agreement') in respect of, inter alia, the areas covered by PEP's 38, 39 and 40 and Exploration Licence 1/60.

The Royalty Agreement pertaining to PEP 38 recited that BHP 'holds the exclusive Petroleum Exploration Permit No. 38 issued under the *Petroleum Act 1958* of the State of Victoria to explore for hydrocarbons within an area comprising 4,450 square miles as shown on the attached plan (hereinafter referred to as "the area") and as specifically described in the Schedule hereto.'[2] The Blackback field is within the area as defined in the Royalty Agreement.[3]

By the Royalty Agreement, BHP did '*bargain sell grant and assign*' to OBI '*an overriding royalty of two and one half per centum (2½%) of the gross value of all hydrocarbons produced and recovered by the Company its successors and assigns within the area.*'[4]

The first discovery of hydrocarbons within 'the area' occurred in 1965 with the discovery of gas at the field known as 'Barracouta' and since then there have been significant discoveries of oil and gas within the area, in respect of which the respondents have paid royalties to the appellant.

In 1967, each of the Commonwealth and the State of Victoria enacted substantially identical legislation in the form of the *Petroleum (Submerged Lands) Acts 1967* ('PSLA'). The PSLA introduced a new exploration permit scheme under which permits were to be issued for an initial term of six years, the permit holder had a right to obtain a renewal subject to compliance with the terms of the permit and the legislation, but the renewed permit would only be issued in respect of 50% of the blocks covered by the previous permit.

In July and August 1975, the respondents under Exploration Permit VIC/P1 drilled 'Hapuku-1', the discovery well for the Blackback field.[5] (The Blackback field is located on blocks 2143, 2215 and 2216 and the

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1 See Interim Award, Appeal Book Vol 8, C1959 [43].

2 Ibid [27].

3 Ibid [29].

4 Ibid [28].

5 Ibid [74], [75], [81]. The VIC/P1 permit was issued under the PSLA regime.

Hapuku-1 well was drilled on block 2215.) After drilling to a total depth of 11,974 feet, the oil column was deemed to be uneconomic, due to the water depth at which it was located, and the well was plugged and abandoned.[6] Subsequently, in 1979, BHP as the VIC/P1 permit holder and in accordance with the PSLA statutory regime relinquished or surrendered one half of the blocks then comprising the permit including blocks 2143, 2215 and 2216. (Under the PSLA regime, BHP, as permit holder, had a discretion as to which of the permit blocks it would surrender and consulted with its joint venturer, Esso, before determining which blocks would be surrendered or relinquished.)

In 1981, some seven years after the abandonment of Hapuku-1, BHP and Esso again tendered for two permit areas in Bass Strait, one of which included block 2143. Subsequently, however, they entered into a 'farm-in' with the successful tenderer, a consortium headed by Shell Development (Aust) Pty Ltd, and by agreement each of BHP and Esso thereby acquired a 25% interest in exploration permit VIC/P19. On 6 August 1986, the Designated Authority consented to the consortium's surrender of 11 of the blocks forming part of permit VIC/P19, including block 2143.

In September 1987, the Designated Authority invited applications for the grant of exploration permits for a number of areas including Area 86-G7, which included the Blackback blocks, blocks 2143, 2215 and 2216. The material released with respect to the applications pointed out that the Hapuku-1 well had proven the area of the Blackback blocks to be prospective for hydrocarbons. In November and December 1986, BHP evaluated and assessed this acreage, noting that '*[t]he most prospective structure is Hapuku*'[7] and, after consulting with Esso, a BHP subsidiary applied for and on 30 July 1987 was granted an Exploration Permit, VIC/P24, for a period of six years in respect of 21 blocks, including blocks 2143, 2215 and 2216.

In February 1989 Esso, at BHP's invitation and with the approval of the Designated Authority, farmed in to Exploration Permit VIC/P24 and entered into a joint venture operating agreement with the relevant BHP subsidiary. Under those arrangements, a 50% interest in VIC/P24 was transferred to Esso in consideration of Esso agreeing, inter alia, to bear 100% of the cost of the commitment wells. In seeking the approval of its Executive Committee to farm-in, Esso stated that the '*prime purpose of farming into this area was to gain equity in the Hapuku-Blackback structure*.'[8] (It was at about this time that the field became known as Blackback.)

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6 Ibid [75].

7 Ibid [88].

8 Ibid [101].

Between 1989 and 1994 Esso, as operator of the joint venture, drilled a number of wells into the Latrobe structure where Hapuku-1 had found oil. All of these wells tested and appraised the oil accumulation discovered by the Hapuku-1 well.

On 8 October 1993, Exploration Permit VIC/P24 was renewed over blocks including 2143, 2215 and 2216. On 20 June 1997, following the identification of a petroleum pool, the Designated Authority declared the Blackback blocks 2143, 2215, and 2216 to be a 'location' for the purposes of s 37 of the PSLA. In January 1998 the Designated Authority granted to the respondents a Production Licence, VIC/L20, over the Blackback blocks for a period of 21 years and on 12 February 1998, the Designated Authority approved the surrender of VIC/P24.

The production of hydrocarbons from the Blackback field commenced during 1999 and is continuing. The Blackback hydrocarbons are being 'produced and recovered' by the respondents by way of a sub-sea completion that is tied into the Mackerel platform, in the geographic 'area' the subject of PEP 38 (ie, both the Blackback field and the Mackerel platform are located within the perimeter of the geographic area described in 1960 as the area covered by PEP 38).

On 26 June 1998, at the request of BHP and Esso, the Minister for Resources and Energy as the Minister for the time being administering the PSLA certified that for the purposes of the *Petroleum Resource Rent Tax Assessment Acts* and associated Acts, '*Production Licences VIC/L1 to VIC/L19 inclusive which make up the single petroleum project in relation to all production licences that are related to the Bass Strait exploration permit in terms of Section 19(1A) of the Act, and the Blackback Production Licence, VIC/L20, shall be treated as a single project*'.[9]

On 16 April 1999 the Chairman of the appellant wrote to BHP noting that he and other officers of the appellant had been informed at a meeting with BHP on 11 March 1999 of BHP's and Esso's view that, because Blackback was not discovered by a successor or assign of BHP, but in 1989 after Esso had farmed in, the Royalty Agreement did not apply to Blackback and hence that override royalty was not payable in respect of production from Blackback.

BHP replied by letter dated 30 April 1999 that: BHP's view, supported by legal advice, is that OBL is not entitled to royalty on production from Blackback. With respect to VIC/L20, OBL's overriding royalty interest was extinguished when the relevant portions of VIC/P1 were relinquished as required by the *Petroleum (Submerged Lands) Act*.[10]

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[9] Ibid [127].

[10] Ibid [131].

Under both the Royalty Agreement and a later Settlement Agreement made on 17 March 1994 (as amended by deed of amendment dated 14 March 1997) (the 'Settlement Agreement') the parties provided for arbitration as the means for resolving any disputes between them.

By letters dated 12 July 2002 and 13 August 2002 the appellant gave notice of dispute to the respondents pursuant to the Settlement Agreement and also pursuant to the Royalty Agreement.[11] In 2003 the appellant appointed a retired state Supreme Court judge as its nominated arbitrator and the respondents appointed a United States' oil and gas lawyer as their nominated arbitrator. Thereafter a retired judge of the Federal Court of Australia was appointed by the two arbitrators as a third arbitrator and chairman of the arbitral panel. Their appointments were formally recorded in Arbitrator Appointment Agreements.

On 27 May 2004, the parties submitted their dispute to arbitration, adopting the procedures set out in the Deed of Submission to Arbitration ('the Deed') and, subject to the Act, made applicable by clause 3 of the Deed. The Deed recorded, inter alia, the parties' 'agreed goal of efficient resolution of the Dispute' and their agreement to use their best endeavours to facilitate the making of an award by the Arbitrators 'expeditiously and without undue delay', their mutual requirement that all hearings be held in private and be kept confidential to the parties, and that any interim award be made in writing, as soon as reasonably practicable, stating the reasons for making the award, and be final and binding upon the parties.[12]

On 30 August 2004, the arbitrators ordered and directed, inter alia, that 'All questions of liability referred to in the pleadings be heard and determined by the Arbitrators and made the subject of an Interim Award before hearing and determining any further issues.'[13]

Clause 12 of the Royalty Agreement provides that it 'shall be interpreted and applied in accordance with the law of the State of New York, United States of America.'[14] It was necessary, therefore, for the arbitrators to make findings of fact as to the content of New York law; [15] and, in particular, as to the applicable principles of contract interpretation under New York law. It was common ground that the question was to be approached by

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[11] Although the respondents initially challenged the Notice of Dispute given under the Settlement Agreement, by the time the hearing commenced there was no dispute between the parties as to the validity of the arbitration and of the appointment of the arbitrators: see Interim Award, Appeal Book Vol 8 C1959 [14].

[12] See Deed of Submission to Arbitration, Appeal Book Vol 1 C68, clauses 7, 21, 25 and 26.

[13] Interim Award, Appeal Book Vol 8 C1959 [18].

[14] Royalty Agreement, Appeal Book Vol 1 C20, clause 12.

[15] *Commonwealth v Yarmirr* (2001) 208 CLR 1, 98.

reference to the manner in which the matter would be decided by the New York Court of Appeals.

The arbitrators delivered their interim award on 6 September 2005. The chairman and the other Australian arbitrator ('the majority arbitrators') delivered a joint interim award in which they concluded that the respondents were liable to pay the appellant the overriding royalties which have accrued and remain unpaid since the production and recovery of hydrocarbons from the Blackback field. In his dissenting reasons, the third arbitrator stated that he would have denied the respondent's claim because, in his view, a New York Court would conclude that the 2½% overriding royalty granted by the Royalty Agreement would not cover or apply to hydrocarbons produced and recovered pursuant to the petroleum production licence covering the Blackback field.

Regrettably, the chairman died on 13 January 2006 and the arbitrators have not since taken any further substantive step.

The judgment below

The respondents challenged the interim award before the judge below on two grounds: first, that the reasons given by the majority arbitrators were so manifestly inadequate as to constitute error of law on the face of the interim award; and, secondly, that the majority arbitrators had so much failed to consider and adjudicate upon substantial and serious submissions and evidence relied upon by the respondents as to amount to technical misconduct.

In dealing with the first of those contentions, the judge noted that the arbitration had been conducted under the *Commercial Arbitration Act 1984* and, therefore, that the arbitrators were required by s 29(1)(c) of that Act to include in their award a statement of the reasons for making the award.

After referring to a number of cases in which the duty of judges and arbitrators to give reasons has been considered, his Honour held that: the standard to be applied in considering the sufficiency of an arbitrator's reasons depends upon the circumstances of the case including the facts of the arbitration, the procedures adopted in the arbitration, the conduct of the parties to the arbitration and the qualifications and experience of the arbitrator or arbitrators. For example, in a straightforward trade arbitration before a trade expert, a less exacting standard than would be expected of a judge's reasons should be applied in considering the adequacy of the reasons for the making of an award. On the other hand, in a large-scale commercial arbitration, where the parties engage in the exchange of detailed pleadings and witness statements prior to a formal hearing before a legally

qualified arbitrator, a higher standard of reasons is to be expected. This is especially so where the arbitrator is a retired judicial officer.[16]

And that: My review of the authorities and the facts of this case leads me to conclude that the arbitrators were under a duty to give reasons of a standard which was equivalent to the reasons to be expected from a judge deciding a commercial case. The arbitration is a large commercial arbitration involving many millions of dollars. It was attended with many of the formalities of a legal proceeding, including the exchange of points of claim and defence and of substantial witness statements. The hearing occupied 15 sitting days. In addition to oral argument, substantial written submissions were made by the parties. The arbitrators were obviously chosen for their legal experience and were retired judges of superior courts. Both sides were represented by large commercial firms of solicitors and very experienced Queens Counsel.[17]

The central issue in the arbitration was whether the expression 'overriding royalty' in the Royalty Agreement was used as a term of art, as the respondents contended (with the result that any right to royalty ceased upon surrender of the tenement to which it related (a 'title based' royalty)), or whether the expression meant simply an additional royalty, as the appellant argued (with the result that royalty was payable in respect of production derived by the respondents from within the area regardless of surrenders (an 'area based' royalty)). Much turned on the decision of the New York Supreme Court Appellate Division in *Hatch v NYCO Minerals Inc,*[18] in which it was held that "'Overriding royalty", by definition, is a retained interest in minerals located on specific property that the royalty holder, ie, lessee, does not actually own', and that '[t]echnical words are to be interpreted as usually understood by the persons in the profession or business to which they relate, and must be taken in the technical sense unless the context of the instrument or an applicable usage or the surrounding circumstances clearly indicate a different meaning'.[19]

Accordingly, the judge held that in order to provide reasons of the standard required by s 29(1)(c), it was necessary for the arbitrators to decide and give reasons for deciding whether 'overriding royalty' was a technical term with a meaning usually understood by persons in the oil and gas industry and, if so, whether the context of the royalty agreement or the

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16 *BHP Billiton Limited & Ors v Oil Basins Limited* [2006] VSC 402 (Unreported, Hargrave J, 1 November 2006) [21].

17 Ibid [23].

18 666 NYS 2d 296 (A.D. 3 Dept 1997).

19 Ibid 298.

surrounding circumstances implied that the parties intended a different meaning from the technical meaning.

The reasons which the majority arbitrators gave on those points were as follows:

177. We turn to the question, on which heavy reliance was placed by the Respondents, whether the Royalty Agreement confers purely contractual rights or a proprietary interest under New York law.

178. Central to the case of the Respondents is their argument based on the decision of the Supreme Court of New York, Appellate Division, in the *Estate of Hatch* (supra), as authority for the proposition that the duration of an overriding royalty must be limited by the duration of the underlying proprietary interest from which it was carved.

179. It is to be noted that *Hatch* was concerned with a "lease" from which the royalty right was said to be carved.

180. In our view, *Hatch* is not authority for the proposition that the expression "*overriding royalty*" has a single fixed meaning in oil and gas custom and usage. Nor did the Supreme Court of New York decide that an overriding royalty must be "*carved out*" of a property interest in hydrocarbons which existed at the time of the making of the agreement that created that interest ("the Royalty Agreement"), or that the duration of the royalty was limited to the duration of the grantor's real property interest. What was said by the Supreme Court in *Hatch* was that an overriding royalty must relate to minerals located on specific property that the royalty holder does not own. Under cross-examination, Judge Simons said that *"there isn't any law in New York State that addresses the question of overriding royalty. There wasn't any such law before Hatch"*. He said also that *"Hatch is not a decision that the Court of Appeals would look at and say, they have defined overriding royalty and that's the only law in New York State on overriding royalty, we would give it very serious consideration, because they wouldn't. They would look at it and say, the facts of the [the respondent's] case are entirely different and the definition of overriding royalty found in the Hatch case will not work here. It is a recognised canon of construction that, if the technical definitions or words do not fit the facts and circumstances before you, then they need not be interpreted in that way*". We accept that evidence as an accurate statement of the relevant law of New York. The Supreme Court in *Hatch* clearly acknowledged that the term *"overriding royalty*" does not have a single invariable meaning under New York law. The Court said that the technical meaning of a word is not followed when "*the context of the instrument or an applicable usage or the surrounding circumstances clearly indicate a different meaning"*. (See 666 NYS 2nd at 298).

181. We also accept the evidence of Judge Simons to similar effect with respect to other decisions of courts of the USA, including the decision of the Supreme Court of Montana in *Aronow v Bishop* (107 Mont 317; 86 p.2nd 644).

182. In our view the submission made on behalf of [the appellant], is correct that the term *"overriding royalty"* never has had and does not now have, a single definite meaning in the United States oil and gas and usage. The expression is and has always been used in the general sense of a royalty that is payable over and above whatever royalty may be customarily due to the owner of the underlying mineral interest. We reject [the respondents'] contention that the term overriding royalty necessarily means in all contexts an interest "*carved out*" of an underlying leasehold or other working interest and limited in duration to the duration of that interest. The evidence before us demonstrates that the term does not and never has had one fixed meaning even in the context of private mineral holdings in the United States, and, a fortiori, in the context of the Royalty Agreement with which this case is concerned.

183. We agree with the following statement of Professor Kuntz in his work, Law of Oil and Gas (2003 ed.) Chapter 16.1 in these terms: *"Under the 'four corners' rule, the court makes every effort to reconcile all provisions of the entire instrument. Stated another way, arbitrary and technical rules of construction are not invoked if the intention of the parties can be determined from the four corners of the instrument without aid. Technical word(s) may not be construed in their technical sense, and strict or literal meaning of the language used will not be applied if it would frustrate the apparent intention of the parties as deducted* [sic] *from the entire instrument*".

184. We note also that this analysis is consistent with the approach taken by the arbitrators in *Asamera (South Sumatra) Limited v Tesoro Petroleum Corporation* (supra).

185. The term "*overriding royalty*" was commonly used in the oil and gas industry in the United States with a range of meanings. We are satisfied that the expression "*overriding royalty"* does not have the special limited meaning for which the Respondents contend.[20]

In the judge's view, those reasons were inadequate because they left the reader to wonder whether the majority arbitrators had decided that the expression 'overriding royalty' was a technical term with a meaning which was usually understood in the oil and gas industry but which was displaced by context, usage or surrounding circumstances, or whether they had decided that the expression 'overriding royalty' was not a technical term with a meaning which is usually understood by persons in the oil and gas industry.

As to the question of whether the majority arbitrators failed to consider and adjudicate upon substantial and serious submissions and evidence relied upon by the appellant, his Honour held that they had so failed, because:

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[20] Interim Award, Appeal Book Vol 8 C1959, [177]-[185].

114. Nowhere in these conclusions is any reference made to the submissions made on behalf of [the respondents] in support [their] contention that usage, context and circumstances did not indicate a different meaning to the technical meaning of "overriding royalty" but, rather, strongly confirmed the "title based" technical meaning for which [the respondents] contended. These submissions were summarised by arbitrators in the interim award, as set out in sub-paragraphs 98(4) to 98(7) above.

115. These submissions made on behalf of [the respondents] were not at the periphery of its case; nor were they so obviously untenable that they could safely be ignored by the arbitrators. The submissions were at the heart of the matter, as demonstrated by the fact that the arbitrators had set them out in some detail in the reasons. This is also demonstrated by the content of paragraph 180 of the reasons, in which the arbitrators express a conclusion on the very issue to which these submissions were directed. The arbitrators were required to do more than merely refer to these submissions. They were required to give intelligible reasons for their rejection. They did not do so; and their reasons on this issue are manifestly inadequate as a result.[21]

Adequacy of reasons

The appellant contends that the judge was wrong in holding that the majority arbitrators' reasons were inadequate. Counsel for the appellant submitted that an informed reader would not be left in any doubt as to what it was that the majority had decided and that it is apparent on a fair reading of the award that the majority arbitrators had in fact given the following multiple and cumulative reasons for their decision:

The words "overriding royalty" have a plain and natural meaning – they are not obviously technical words conveying a technical meaning, and the Royalty Agreement is completely harmonious when the words are given their ordinary meaning.

The evidence demonstrated that the expression was commonly used with a range of meanings, never had one fixed meaning and did not have the special meaning for which the [respondents] contended [par 182 and 185].

The [respondents] founded their special limited "carve out" meaning on *Hatch,* but *Hatch* does not establish that special meaning [par 180,182].

The meaning for which the [respondents] contended was inconsistent with the context and surrounding circumstances of this Royalty Agreement [par 183].

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[21] *BHP Billiton Limited & Ors v Oil Basins Limited* [2006] VSC 402 (Unreported, Hargrave J, 1 November 2006) [114]-[115].

We do not accept that argument. Superficially, it appears to be attractive. Proposition (2) looks to be supported by paragraphs 182 and 185 of the majority arbitrators' reasons; proposition (3) seems to be underpinned by paragraphs 180 and 182; proposition (4) appears as based on paragraph 183; and proposition (1) might be viewed as a summary of the other propositions. But, as the judge said, among other difficulties with the analysis is that paragraphs 180 and 182 are inconsistent. The last two sentences of paragraph 180 imply that 'overriding royalty' is a term of art of which the technical meaning may be displaced by context. Contrastingly, paragraph 182 proceeds as if the expression 'overriding royalty' has 'always only ever been used in the general sense of a royalty that is payable over and above whatever royalty may be customarily due to the owner of the underlying mineral interest'. Further, as his Honour observed, the only reason given for concluding that the expression 'overriding royalty' has only ever been used in the general sense identified is what the majority arbitrators described as the 'evidence before us'. They did not identify which of the evidence before them they had in mind, or give reasons for preferring it to the substantial body of expert opinion evidence which pointed the other way.[22]

The only hint they gave was this: The parties also basically agree about what the relevant principles of interpretation of New York law are, but there is some disagreement, more on the relevance of certain of those principles to this arbitration and their application to it, rather than the substance of the principles themselves. This attitude of the parties substantially reflects the evidence of the expert witnesses. We observe, however, that in some respects the evidence of some of the expert witnesses, in particular Judge Simons and Judge Levine, differs from the other. Having read and considered their statements of evidence and heard their oral evidence, where these differences occur we generally prefer the evidence of Judge Simons.[23]

So far from clarifying the position, however, the hint adds considerably to the uncertainty. It appears in a section of the reasons which is headed 'Principles of Interpretation of the Royalty Agreement and the Consultancy Agreement'. That implies that some part of the 'disagreement' was perceived to relate to 'the principles' as well as to 'their application'. But the only particulars of the 'disagreement' given are that the evidence of 'Judge Simons and Judge Levine differs from the other'. One is not told in what respects they were perceived to differ, and in particular whether as to principles or application. Further, as to the resolution of 'these differences',

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[22] *BHP Billiton Limited & Ors v Oil Basins Limited* [2006] VSC 402 (Unreported, Hargrave J, 1 November 2006) [109].

[23] Interim Award, Appeal Book Vol 8 C1959 [154].

the only reason provided is the Delphic incantation that the majority arbitrators '*generally* prefer the evidence of Judge Simons'.[24] It is not said which parts of it or why. Moreover, the other expert witnesses on both sides (in particular Mr. McCollam and Professor Martin who were called by the respondents) are not mentioned, still less said to have been rejected because of something uttered by Judge Simons or for some other reason; and that latter omission assumes particular significance once it is understood that there were aspects of the matter with which those witnesses dealt that were arguably not dealt with by Judge Simons (although covered by other experts called by the appellant). It implies that Mr. McCollam's and Professor Martin's evidence or at least parts of it may not have been considered at all.

The uncertainty is then further exacerbated by the observation in paragraph 181 that 'we also accept the evidence of Judge Simons *to similar effect*[25] with respect to…*Aronow v Bishop* (107 Mont 317; 86 p.2nd 644)'. For as far as we can see, Judge Simons accepted that *Aronow* and other 'Preference Rights' cases recognised that a strict application of the technical definition of an ORR [overriding royalty] would have effectively extinguished the royalty holders' rights once prospecting permits were surrendered or exchanged for mining leases (see, e.g., *Aronow*, 86 P.2d at 646). Admittedly, Judge Simons later went on to say that: 'it would be open to the [New York] Court of Appeals to conclude that the so-called "Preference Rights" cases cited by the respondents' experts (particularly Mr. McCollam (at [27]-[33]) do not provide an analogous and persuasive basis for narrowly limiting the extension of any royalty obligation under the 1960 Royalty Agreement to mining titles "directly derivative" of PEP 38 (or its replacement Permit Vic/P1).' But that may just mean that the expression 'overriding royalty' was a term of art with a technical meaning of a 'carved out' interest which was in this case excluded by the context.

The same deficiency infects the asseveration in paragraph 182 that: 'The evidence before us demonstrates that the term ["overriding royalty"] does not and never has had one fixed meaning even in the context of private mineral holdings in the United States, and *a fortiori*, in the context of the Royalty Agreement with which this case is concerned'. There is no reference there or elsewhere to any of the substantial contrary body of evidence adduced by the respondents and there is no explanation of why it was rejected.

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[24] Emphasis added.

[25] Emphasis added: *ie* similar effect to 'that the term *"overriding royalty*" does not have a single invariable meaning under New York law.'

There is next the reference in paragraph 184 to *Asamera (South Sumatra) Limited v Tesoro Petroleum Corporation*[26] as being consistent with the approach earlier mentioned in paragraph 183 (that 'Technical word[s] may not be construed in their technical sense, and strict or literal meaning of the language used will not be applied if it would frustrate the apparent intention of the parties as deducted [*sic*] from the entire instrument'). That implies an acceptance of the proposition that 'overriding royalty' has a technical meaning which may have been excluded by context. But if it were thought that the context here excluded the technical meaning, there is no explanation of why it was thought to do so.

Finally, the observations in paragraph 185 (that ' "overriding royalty" was commonly used in the gas and oil industry in United States with a range of meanings') reverts to the earlier theme of paragraph 182 (that ' "*overriding royalty*" never has had and does not now have, a single definite meaning in the United States oil and gas usage'). But that is at odds with the second sentence of paragraph 182 (that 'The expression is and has always been used in the general sense of a royalty that is payable over and above whatever royalty may be customarily due to the owner of the underlying mineral interest') and at odds with the strong indication implicit in the last sentence of paragraph 183 (that 'overriding' royalty is a 'technical word' with a 'technical sense' but that its 'strict or literal meaning of the language used will not be applied if it would frustrate the apparent intention of the parties as deducted [*sic*] from the entire agreement').

Perhaps one is to read the reasons as meaning that, if the expression 'overriding royalty' is a term of art or 'technical word' with a 'technical meaning', the context implies that it was not used with that meaning in the Royalty Agreement. But, as the judge said,[27] if that is the case, the reasons are inadequate because of their failure to condescend to any analysis of the competing evidence and reasons for rejecting it in favour of the appellant's contentions. The most that can be gleaned from what the majority arbitrators said is that they attached some special significance to Judge Simons' opinion[28] compared to the other experts, and there is no explanation of why they did. We are reminded of Henry LJ's animadversion upon the reasons of the judge in *Flannery v Halifax Estate Agencies Ltd*:[29]

That passage is the only passage in the judgment which purports to set out reasons for the decision. The appellants complain that in truth no

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[26] 807 F Supp 1165 (SD NY 1992).

[27] *BHP Billiton Limited & Ors v Oil Basins Limited* [2006] VSC 402 (Unreported, Hargrave J, 1 November 2006) [112].

[28] Interim Award, Appeal Book Vol 8 C1959 [154].

[29] [2000] 1 WLR 377, 380; see also *Waterways Authority v Fitzgibbon* (2005) 79 ALJR 186, 221 ALR 402, 428-429 (Hayne J).

reasons are given we do not know why the judge preferred the defendant's expert evidence to that of the plaintiff….But the judgement is entirely opaque it gives the judge's conclusion, but not his reasons for reaching that conclusion.

The appellant contends that, even if that be so, there was abundant evidence to support the majority arbitrators' conclusion that 'overriding royalty' did not have the meaning for which the respondents contended, and that it may be assumed that the majority arbitrators came to their decision on the basis of that evidence.

Counsel for the appellant relied in particular on the following:

Observations in Kuntz, *Law of Oil and Gas*,[30] and Collins, '*The Rights of the Overriding Royalty Owner*'[31] (*'Royalties in addition to the usual one-eighth reserved in the oil and gas lease are usually classified as overriding royalties*') to the effect that 'overriding royalty' may mean nothing more than a royalty 'in addition' to (or over and above) any royalty to be paid to the owner of the underlying mineral estate (typically, the lessor).

This passage from Professor Summers treatise:

Perhaps the only safe way to define the term 'overriding royalty' is to say that it is a fractional interest in the gross production of oil and gas, in addition to the usual royalties to be paid to the lessor. The term m[a]y be used in referring to a non-participating royalty interest in perpetuity or for a term of years created by the land or mineral owner prior to a lease for oil and gas.[32]

This further observation in Professor Summers' treatise, to the effect that the term 'overriding royalty' can be used to describe a royalty right that is granted or promised in relation to a lease or other working interest that may be acquired in the future: A prospective lessee may agree to pay an overriding royalty, a certain share of the production, to another person as consideration for his services in procuring a lease on certain lands.[33]

In our view, however, counsel's argument breaks down at a number of levels. To begin with, the arbitrators did not refer to the identified passages from Kuntz or Summers and it is not otherwise apparent that they took those passages into account. So, to borrow again from the judgment of Henry LJ in *Flannery*: we do not know whether the assumed thought process was the judge's actual thought process…on what the judge said we

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30 §63.2 at 218-19.

31 (1970) 39 *Journal of the Kansas Bar Association* 235.

32 W L Summers, *The Law of Oil and Gas*, (1968) 624.

33 Ibid 625.

do not know why he preferred the defendants' experts, nor whether that was for good reason or bad. We do not know because reasons were not given.[34] Secondly, as we read the cited passage from Summers, it accords with the view that 'overriding royalty' is a term of art in United States' oil and gas law signifying an overriding interest which is 'carved out' of an oil and gas lease and which, therefore, is limited in duration to the term of the lease.

The cited passages from Kuntz and Collins, when read in context, appear also to confirm that view:

(1) The thrust of the chapter in Kuntz[35] from which the cited passage is taken appears as follows: An overriding royalty is a nonoperating interest that is carved out of the working interest of an oil and gas lease. It may be created by conveyance of the overriding royalty by the owner of the lease,[36] but is it more commonly created by reservation upon the transfer of an oil and gas lease.

…Occasionally, the parties refer to the additional royalty as an "overriding royalty" and thereby create the possibility of confusion with the overriding royalty carved out of an oil and gas lease. The use of the term "overriding" to describe an additional royalty adds nothing to the meaning of "royalty" and may create doubt as to whether or not the additional royalty is intended to override other limiting provisions of the lease, such as the lesser interest clauses… *Because of the problems that may be created, the use of the term "overriding royalty" in an oil and gas lease to describe an additional royalty should be avoided.* Despite this occasional use of "overriding royalty" to describe an additional royalty, the term will be used herein in its conventional sense to describe an interest carved out of an oil and gas lease by the lessee. An overriding royalty is an interest in the oil and gas lease out of which it is carved and cannot be a property interest of greater dignity than the lease itself… In various jurisdictions it has been variously held that an overriding royalty is "land", "real property", or "real estate", as those terms are used interchangeably in a statute providing for attachment… An overriding royalty created from a federal oil and gas lease is real property so that it is a proper subject for a quiet title action and is subject to the recording statutes…

From the various cases to which reference has just been made and from others, it can be concluded that the overriding royalty is generally regarded to be an interest in land. It is, however, a non-possessory interest in land, with the result that the owner is not entitled to possessory remedies such as

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34 [2000] 1 WLR 377, 382.

35 Eugene Kuntz, *Law of Oil and Gas*, (2003) §63.2.

36 See, eg, *La Laguna Ranch Co. v Dodge*, 18 **Cal** (2d) 132, 114 P(2d) 351, 135 ALR 546 (1941)*; Phillips v Bruce,* 41 **Cal** App (2d) 404, 106 P(2d) 922 (1940).

trespass to try title, and partition of such interest cannot be compelled by the owner of the working interest, except in extreme circumstances.

…

The overriding royalty is carved out of an oil and gas lease, but the owner is not a cotenant in the operating interest with the lessee, nor can it be said that their arrangement creates a partnership. Being a nonoperating interest that is carved out of the oil and gas lease, the overriding royalty has been regarded as an encumbrance on the working interest and is therefore free from liens thereafter imposed on the working interest.

…

The overriding royalty is created out of an oil and gas lease and is necessarily limited in duration to the life of the lease. Accordingly, the overriding royalty will terminate upon expiration of the lease, upon termination of the lease for failure of the lessee to comply with the drilling clause, and upon a surrender of the lease by the lessee.

…

In the absence of some special provision in the instrument creating the interest, the overriding royalty applies only to the lease out of which it was created and does not apply to any future leases granted. If the future lease is a "direct outgrowth" of the prior lease, then the overriding royalty may apply. For example, it has been held that if the new lease is acquired pursuant to a right created by the old lease, it will be subject to the overriding royalty reserved on assignment of the old lease.[37]

(2) Similarly, in the article by Collins to which the appellant refers, it is said that:

The overriding royalty owner's rights are akin to those of the lessee, in that their tenure is dependent on the continued life of the lease, even though all of the expense and control of development is borne by the lessee. His interest quickly shifts to that of the lessor when questions arise as the diligent and proper operation of the lease.

…

It is generally recognized that the overriding royalty is extinguished with the bona fide termination or cancellation of the lease. Many instances reach the courts where the lessee fails to obtain production during the primary term and later acquires a new lease on the same premises. Where the instrument creating the overriding royalty is silent regarding extensions or renewals, the overriding royalty owner must show a breach of fiduciary

[37] Citations omitted, emphasis added.

obligation and a conspiracy to deprive him of his interest before he is granted relief.

…

In determining the rights of the overriding royalty owner in the termination of his interest, most of the cases involved situations where the lease was permitted to lapse through the expiration of the primary term or failure to pay delay rentals. A different situation arises where the lessee releases a portion of the acreage held by production. In either event, the good faith of the release appears to be the criteria in resolving the rights of the overriding royalty owner… [38]

Thirdly, the views of Judge Simons, to which the majority arbitrators referred in paragraph 180 of their reasons, were directly contradicted by the opinion of Judge Levine, and by the opinions of Mr. McCollam and Professor Martin, as follows:

Judge Levine said: When parties to an agreement employ technical phrases having well understood meaning or significance in the profession or business to which they relate, the New York courts will interpret the contractual language in accordance with that understanding. (See, *Malbone Garage Inc v Minkin* 272 App Div 109, 113 [2d Dept 1947], aff'd, 297 NY 677 [1947]; *Hatch v NYCO Minerals Inc,* 245 A.D. 2d 746, 747-48 [3d Dept 1997]). Of particular precedential significance, the Appellate Division in Hatch, relying in part upon case law from the courts of mineral producing jurisdictions, found that the phrase "overriding royalty" has such a well understood "unambiguous" meaning. Therefore, the New York courts, in interpreting the language of Clause 1 of the Royalty Agreement, giving Dr Weeks' nominee an "overriding royalty of …(2 1/2 %) of the gross values of all hydrocarbons produced and recovered by [BHP] within the area", would look to the interpretation of overriding royalty by the courts of mineral producing jurisdictions that have frequent occasions [sic] to construe such royalty agreements. Analysis of the legal authorities discloses that the clear prevailing, and in my opinion the more analytically sound, view treats an overriding royalty as limited in duration to the life of the lease or other working interest under which it was created and, if the parties agree, to renewals and extensions thereof.[39]

Mr. McCollam said:

The most pertinent part of *Hatch* for present purposes is the finding by the court that "overriding royalty" is a technical term of art which must "be

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[38] "The Rights of the Overriding Royalty Owner" (1970) Journal of the Kansas Bar Association 235, 235-237.

[39] Witness Statement of Howard A Levine, Appeal Book Vol 3, C523 [37].

interpreted as usually understood by persons in the profession or business to which [the term] relate[s], and must be taken in the technical sense unless the context of the instrument or an applicable usage or the surrounding circumstances clearly indicate a different meaning". *Id.* at 747.

…

As previously noted, the treatment of overriding royalties in the case law and doctrinal authorities described above is consistent with my understanding of the term gleaned from my 45 years as a legal practitioner focusing on oil and gas law. It is also consistent with my teachings at Tulane University during my tenure as a professor of mineral law. Based upon that experience, I believe that if a contrary view was adopted by a New York court that would be anomalous and inconsistent with established principles of U.S. mineral law…[40]

Professor Martin said (with references to authority):

The term "overriding royalty" has a well understood meaning in the oil and gas industry in the United States. As defined in the Treatise and Manual of Terms for which I am now a revision author, Pat Martin & Bruce Kramer, *Williams & Meyers Oil and Gas Law* (2004) vol. 8 p. 748, 'Overriding royalty' is: An interest in oil and gas produced at the surface, free of the expense of production, and in addition to the usual landowner' royalty reserved to the lessor in an oil and gas lease…'

…

The term "overriding royalty" was chosen by the persons for whom the Claimant [the appellant] was established. A letter of Lewis G. Weeks of October 5, 1960 indicated that the Draft of Letter Agreement and accompanying Form of Overriding Royalty Agreement were prepared by an experienced oil industry counsel for him. He noted that "carried interest" had been used in a previous letter by him but "Overriding royalty is a more correct term for the kind of participation which I then so very briefly explained". He said that the overriding royalty was similar to other provisions and overriding royalty to other agreements of recent date for like service.

Dr. Weeks was being advised by and much of the drafting of both agreements was inspired by Paul N. Temple. A 1948 graduate of the Harvard Law School, Mr. Temple from 1954 to 1960 (when he drafted the royalty agreement) was an international petroleum concessions negotiator for Exxon Corporation…

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[40] Statement of John M McCollam Appeal Book Vol 3 C595,[16], [22] (references omitted).

Dr Weeks described Mr. Temple to BHP as having "the very best experience in matters of this kind" and as "an experienced oil industry counsel." … "Mr. Temple…can fairly be thought to have been familiar with the language of the oil industry in the United States and with the principles underlying if not the actual details of much United States oil and gas case law…"

Also found by the arbitrators: "BHP and their senior management had little or no experience in the discovery and production of petroleum. They found some of the technical phraseology emanating from the United States obscure. The phrase 'overriding royalty' was new to them. They asked for its interpretation."

I do not believe there is ambiguity in the use of the term overriding royalty in the Consultancy Agreement and the Royalty Agreement: it is an interest carved out of a lessee's share of oil and gas, and overriding royalty cannot apply to minerals mined from lands in which a lessee does not have an interest…. [41]

Fourthly, apart from noting that Judge Lewis and Mr. McCollam and Professor Martin had given evidence, the majority arbitrators said nothing at all about their evidence.[42]

Counsel for the appellant argued in the alternative that, as pleaded, the respondents' case was put on the single narrow basis that the expression 'overriding royalty' had but one immutable meaning of a proprietary interest 'carved out' of an underlying leasehold interest and that, whatever else might be said about the quality of the majority arbitrators' reasons, they were adequate to make plain why they rejected that view of the matter. Further or alternatively, counsel submitted, although the respondents' pleaded case was that 'overriding royalty' was a proprietary interest 'carved out' of an underlying leasehold interest, the respondents had later come to realise that, because PEP 38 was not a lease and did not confer any rights to acquire a lease, the 'carve out' argument was inapposite and the respondents had then sought to prove (by invocation of the American 'Preference Rights' cases) that 'overriding royalty' was capable of applying by analogy to something in the nature of a usufruct which was granted during the life of and thus derived from an exploration or similar prospecting permit (not amounting to a lease or other interest in property). According to the appellant, therefore, it was plain that the respondents had not been able to prove their pleaded case and so they had been bound to fail.

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41 Statement of Patrick H. Martin, Appeal Book Vol 3, C658 [44]-[51].

42 Interim Award, Appeal Book Vol 8, C1959 [24].

We reject those submissions. The respondents' case as pleaded was not that the expression had but one immutable meaning but rather that '[t]he outstanding characteristic of an overriding royalty, which has an unambiguous meaning under New York law, is that its duration is limited by the duration of the lease under which it is created' and that '[t]he overriding royalty conferred by the PEP38 Royalty Agreement was accordingly limited by, and was at all times dependent for its existence on, PEP38 or VIC/P1.'[43] As we see it, that left scope, or at least it was treated between the parties as leaving scope, for the respondent to prove a case that, although PEP 38 did not confer an interest in real property, or indeed any right or preference to acquire a right to mine, the American Preference Rights cases implied (by way of analogy to overriding royalties carved out of underlying leaseholds) that an overriding royalty granted during the life of a permit such as PEP 38 was limited in duration to any mining rights acquired immediately upon the surrender of that permit. In the result, that was the case put in the expert witness statements of Mr. McCollam and Professor Martin, and the appellant's expert witnesses joined issue with it in their expert statements, and that was the case the arbitrators were required to decide.[44]

As has been seen, however, they failed to deal or at least to deal adequately with the material issue of whether 'overriding royalty' was a technical term of art with a generally accepted meaning in United States' oil and gas law. They failed to identify sufficiently the evidence upon which they came to the conclusion that 'overriding royalty' has 'only ever been used in the general sense of a royalty that is payable over and above whatever royalty may be customarily due to the owner of the underlying mineral interest'. And they did not assign any reasons for rejecting the large body of evidence and United States' authorities upon which the respondents relied to establish that 'overriding royalty' is a term of art which is generally understood in United States' oil and gas law and thus in New York law as meaning something *'carved out'* of a property interest in hydrocarbons which existed at the time of the making of the agreement of which the duration is limited to the grantor's real property interest and that it applied analogously to exploration and prospecting permits in the nature of PEP 38.

The appellant contends that so to criticise the majority arbitrators' reasons portrays a misunderstanding of the arbitral function. Counsel for the appellant argued that it was unnecessary for the reasons to be anything like as rigorous or complete as those demanded by the judge. In their

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[43] Amended Points of Defence, Appeal Book Vol 2, C274 [91B]-[91C].

[44] Cf. *Dare v Pulham* (1982) 148 CLR 658, 664; *Water Board v Moustakas* (1988) 180 CLR 491, 497; *Tourello Nominees Pty Ltd v Begg Dow Priday Advertising Pty Ltd* [1986] ANZ Conv R 613, 616-7.

submission, the dual requirements that arbitrators provide a statement of their reasons *for* making the award[45] and do so 'as soon as reasonably practicable'[46] fundamentally distinguished this arbitration from a curial proceeding,[47] and implied that it was enough that the arbitrators set out the factors that supported the meaning of the expression which they preferred, had regard to contextual matters, contrasted the context of the private mineral holdings in the United States with the context of the Royalty Agreement, including the statutory regime prevailing at the time the agreement was entered into, and found on the evidence before them that 'overriding royalty' does not and never has had one fixed meaning.

We do not accept those submissions either. As already noted, the requirement to give reasons arose out of s 29(1)(c) of the *Commercial Arbitration Act 1984*.[48] The extent of that requirement is informed by the purposes of the Act. As Giles J observed in *R P Robson Constructions v D & M Williams*,[49] the Act fundamentally altered the approach to the provision of reasons in commercial arbitration, by taking away the jurisdiction to set aside an award on the ground of error on the face of the award and replacing it with a right to seek leave to appeal on any question of law arising out of the award which the court considered could substantially affect the rights of one or more of the parties. In order to enable the court to see whether there has been an error of law, s 29 provides that the award must be in writing and that the arbitrator must include a statement of reasons. And in order to be utile, the requirement is for reasons sufficient to indicate to the parties why the arbitrator has reached the conclusion to which he or she has come. To that extent, the requirement is no different to that which applies to a judge. Of course it is understood that arbitrators may not always be skilful in the expression of their reasons.

Consequently, it is accepted that a court should not construe an arbitrator's reasons in an overly critical way. But it is necessary that an arbitrator deal with issues raised and indicate the evidence upon which he or she has come to his or her conclusion. Accordingly, if a party has relied on evidence or material which the arbitrator has rejected, it is ordinarily necessary for the arbitrator to assign reasons for its rejection.

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[45] See *Commercial Arbitration Act 1984* s 29(1)(c) and Deed of Submission to Arbitration, Appeal Book Vol 1, C67, clause 25.

[46] Deed of Submission to Arbitration, Appeal Book Vol 1, C67, clause 25.

[47] In *Imperial Leatherware Co Pty Ltd v Macri & Marcellino Pty Ltd* (1991) 22 NSWLR 653 Rogers CJ observed (at 661) that '[t]he heart of the arbitral procedure lies in its ability to provide speedy determination of the real issues'.

[48] And also out of the Deed but it was common ground that the scope of the obligation imposed under the Deed was relevantly the same as under the Act.

[49] (1990) 6 Building and Construction Law 219, 221-2.

Counsel for the appellant relied on an observation in the second edition of *Mustill and Boyd*[50] to the effect that an award need not set out the evidence from which an arbitrator has deduced his findings of fact because the findings of fact are not open to review and therefore a statement of the evidence will not serve any useful function. But, in our view, counsel's reliance on that observation is misplaced in this context. It was directed to the sort of reasons required to be given in response to an order made under s 1(5) of the *Arbitration Act 1979* (Eng).[51] That section expressly limited the power to order reasons to requiring an arbitrator: to state the reasons for his award in sufficient detail to enable the court, should an appeal be brought under the section, *to consider any question of law arising out of the award.*[52]

Contrastingly, the requirement to give reasons under s 29(1)(c) of the *Commercial Arbitration Act 1984* (which is now substantially replicated in s 52(4) of the *Arbitration Act 1996* (Eng)) is not so limited. It reflects the expression in Article 31 of the UNCITRAL *Model Law on International Commercial Arbitration* of 'a basic rule of justice that those charged with making a binding decision affecting the rights and obligations of others should… explain the reasons for making that decision.'[53] The effect of the section, as Sir Harry Gibbs explained in an extra-curial lecture delivered in 1988, is that: The arbitrator is required to explain in the reasons which form part of the award why he or she reached the decision which the award embodies. To do that it is necessary to state the relevant facts *and to explain why each issue of fact was resolved in the way in which the arbitrator resolved it.* It is further necessary to state what conclusion the arbitrator reached on each question of law or of mixed law and fact and how that conclusion was reached…[54]

Counsel for the appellant referred to an observation in *Jacobs*[55] to the effect that s 29(1)(c) of the Act requires a *statement* of reasons and that the use of the word 'statement' is not surplusage but rather focuses on a legislative intent of something less than the full and comprehensive reasons which may be expected from a Supreme Court judge.[56] But assuming

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[50] Lord Mustill & Stewart C Boyd QC, *The Law and Practice of Commercial Arbitration in England*, (2nd ed, 1989), 377.

[51] Which is no longer the law in England. See the commentary on s 52 of the *Arbitration Act 1996* (Eng) in Lord Mustill and Stewart C Boyd, QC, *Commercial Arbitration:* 2001 Companion volume to the Second Edition (2001), 335-336.

[52] Emphasis added.

[53] Departmental Advisory Committee on Arbitration Law, Report on The Arbitration Bill, Clause 52, which is reproduced as Appendix 1 to Mustill & Boyd above n 49, 436.

[54] "The John Keays Memorial Lecture: Reasons for Arbitral Awards" (1988) 7 *The Arbitrator* 95, 102, referred to in Jacobs, *Commercial Arbitration Law and Practice*, Vol 1B, (update 58), [28.80] (emphasis added).

[55] Ibid.

[56] Ibid.

without deciding that is so, it remains that an arbitrator's reasons must be intelligible in the sense already described and we observe that a good deal of the text in *Jacobs* which follows the cited passage is strongly supportive of that view. In a later stated proposition, *Jacobs* makes the point that judicial decisions and pronouncements in New South Wales show that judges in the Commercial Court require something more than a mere statement, and the point is then emphasised by *Jacobs*' citation of the following extra-curial pronouncement of Smart, J: It is important that comprehensive findings of fact be made. Full reasons simply set down the processes which the arbitrator adopted (or should have adopted) in coming to his conclusion. The need to give reasons and think carefully helps you to arrive at the correct conclusion.[57]

Counsel for the appellant argued that, even if that were so, the judge in this case was in error in assimilating the duty imposed on the arbitrators to the duty which applies to judges to the extent of concluding that 'the arbitrators were under a duty to give reasons of a standard which was equivalent to the reasons to be expected from a judge deciding a commercial case'.[58] Counsel submitted that the judge also erred in concluding that subjective matters (such as the background and experience of the arbitrator and the parties' respective counsel and solicitors) were determinative of the standard of the reasons required to be delivered in an arbitration, as reflected by his reference to the following circumstances:

(a) The arbitration was a large commercial arbitration involving many millions of dollars.

(b) It was attended with many of the formalities of a legal proceeding, including the exchange of points of claim and defence and of substantial witness statements.

(c) The hearing occupied 15 sitting days.

(d) In addition to oral argument, substantial submissions were made by the parties.

(e) The arbitrators were obviously chosen for their legal experience and were retired judges of superior courts.

(f) Both sides were represented by large commercial firms of solicitors and very experienced Queen's Counsel.

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[57] Ibid.

[58] *BHP Billiton Limited v Oil Basins Limited* [2006] VSC 402 (Unreported, Hargrave J, 1 November 2006) [23].

In our view, the judge did not err as alleged. The arbitrators' decision in the present case called for reasons of a judicial standard. As with reasons which a judge is required to give, the extent to which an arbitrator needs to go in explaining his or her decision depends on the nature of the decision.

The subjective matters to which the judge referred did not dictate the applicable standard, but rather, reflected the nature of the decision. To adopt and adapt McHugh JA's analysis in *Soulemezis v Dudley (Holdings) Pty Ltd*,[59] if the only issue before an arbitrator is whether a claimant has sustained injury and the issue turns solely on the credibility of the claimant's testimony, a simple finding that he or she fell and sustained injury might be enough. But if, in addition to the claimant's credibility, other matters are relied on as going to the probability or improbability of the claimant's case, such a simple finding will not be enough.[60] Plainly, a judge is bound to refer to relevant evidence and, where there is a conflict of a significant nature, to provide reasons for choosing one over side over the other.[61] A judge is also bound to deal with central contentions, even if sometimes only briefly, and at least to the extent of explaining in general terms why he or she has rejected them.[62] Accordingly, where evidence and contentions combine as they are prone to do in the form of expert evidence, and the dispute involves 'something in the nature of an intellectual exchange with reasons and analysis advanced on either side', it is plain that the judge is bound to enter into the issues canvassed before the court and to provide an intelligible explanation as to why the judge prefers one case over the other.[63] In our view, an arbitrator is subject to similar obligations.

Admittedly, as McHugh JA pointed out in *Soulemezis*,[64] it is only in relatively recent times that judges have been required to give reasons of that kind. The obligation to do so evolved over the last century out of the creation of rights of appeal by statute, the enactment of stated case and review procedures, and the transfer from juries to judges of the function of deciding questions of fact.[65] It must also be acknowledged that, in a number

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59 (1987) 10 NSWLR 247.

60 Ibid 281.

61 *Beale v Government Insurance Office of NSW* (1997) 48 NSWLR 430, 443-4; *Fletcher Construction Australia Ltd v Lines MacFarlane & Marshall Pty Ltd (No 2)* (2002) 6 VR 1, 31-32.

62 *R v Maxwell* (1998) 217 ALR 452, 473; *Fletcher Constructions Australia Ltd v Lines MacFarlane & Marshall Pty Ltd (No 2)* (2002) 6 VR 1, 44.

63 *Eckersley v Binnie* (1988) 18 Construction Law Reports 1, 77-8; *Flannery v Halifax Estate Agencies Ltd* [2000] 1 WLR 377, 380; *English v Emery Reimbold & Strick Ltd* [2002] 1 WLR 2409, 2418; *Archibald v Byron Shire Council* (2003) 129 Local Government and Environmental Reports of Australia 311, 323 (Sheller JA).

64 (1987) 10 NSWLR 247.

65 Ibid 277.

of the cases concerning the scope of the judicial obligation to give reasons, a principal consideration has been that reasons should be sufficient to enable courts of appeal to see if there has been any error in the process of fact finding. There is no right of appeal on questions of fact from the decision of an arbitrator. But the judicial obligation to give reasons is not based solely on rights of appeal. Ultimately, it is grounded in the notion that justice should not only be done but be seen to be done. And in point of principle, there is not a great deal of difference between that idea and the imperative that those who make binding decisions affecting the rights and obligations of others should explain their reasons. Each derives from the fundamental conception of fairness that a party should not be bound by a determination without being apprised of the basis on which it is made.[66] So, in arbitration, the requirement is that parties not be left in doubt as to the basis on which an award has been given. To that extent, the scope of an arbitrator's obligation to give reasons is logically the same as that of a judge.[67]

As has been noticed, what is needed to satisfy that requirement will depend upon the particular circumstances of the case. If a dispute turns on a single short issue of fact, and it is apparent that the arbitrator has been chosen for his or her expertise in the trade or calling with which the dispute is concerned, a court might well not expect anything more than rudimentary identification of the issues, evidence and reasoning from the evidence to the facts and from the facts to the conclusion.[68] Byrne J captures the point in this dictum in his Honour's judgment in *Schwarz*:[69]

In what are often called trade arbitrations, the parties and the Arbitrators are all engaged in a particular trade. In such an arbitration the reasons may be expressed in the jargon of the trade or they may ignore matters which will be well known to the participants. Such an award which may appear deficient to an outsider, may nonetheless satisfy the fundamental purpose of the statement of reasons. It cannot be the case that an award should be drafted only with an eye to informing an appeal court which may be unfamiliar with the trade and its practices.[70]

Contrastingly, however, in complex commercial arbitrations, it may appear that the determination of the dispute demands reasons considerably

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66 Ibid 257-258, 271. See also *J H Rayner (Mincing Lane) Ltd v Shaher Trading Co* [1982] 1 Lloyd's Law Reports 632, 637; *English v Emery Reimbold & Strick Ltd* [2002] 1 WLR 2409, 2417.

67 *Gas & Fuel Corporation of Victoria v Wood Hall Ltd* [1978] VR 385, 394; *Villani v Delstart Pty Ltd* [2002] WASC 112 [42].

68 Lord Mustill and Stewart C Boyd, *The Law and Practice of Commercial Arbitration in* England (1st ed, 1982) 552.

69 *Peter Schwarz (Overseas) Pty Ltd v Morton* [2003] VSC 144.

70 Ibid [35].

more rigorous and illuminating than the mere *ipse dixit* of a 'look-sniff'[71] trade referee. And in cases like the present, which involve an intellectual exchange with reasons and analysis advanced on either side, conflicting expert evidence of a significant nature and substantial submissions, the parties to the dispute are almost certain to be left in doubt as to the basis on which an award has been given unless the reasons condescend to an intelligible explanation of why one set of evidence has been preferred over the other; why substantial submissions have been accepted or rejected; and, thus, ultimately, why the arbitrator prefers one case to the other. Hence, in our view, the reasons in this case should have been of that standard.[72]

Furthermore, in the usual course of events, disputants choose their arbitrators on the basis of qualifications, knowledge or a skill which is fitted to the nature of the dispute, and so to preparing the type of determination which is appropriate. Disputants are also likely to adopt a form of arbitral proceeding which is consonant with those requirements. To that extent, as the judge said in effect, the disputants' choice of arbitrator and the structure of their arbitral proceeding may reflect the nature of their dispute and so the nature of the reasons required.[73] It would not facilitate the object of s 29 of the *Commercial Arbitration Act 1984*, and it could well discourage the continuing subjection of substantial commercial law disputes to arbitration, if the court were to tolerate less.

Contrary to the appellant's submissions, however, that does not imply that the court is to approach the work of commercial arbitrators with a view to finding fault. The arbitration of commercial disputes is to be encouraged and hence arbitrators are free to a large extent to express their reasons as they choose. Nor does it follow that the court demands a higher standard of reasoning from retired judges and other legally trained arbitrators than from arbitrators who are not so trained. As Buchanan JA observed in the course of the hearing, it is the nature of a dispute which sets the standard for reasons, not the nature of the arbitrator.

The appellant contends that the judge was in error in stating that '[t]his is especially so where the arbitrator is a retired judicial officer'.[74] Counsel for the appellant submitted that the judge thereby implicitly accepted that

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[71] *Bremer Vulkan Schiffbau and Maschinenfabrik v South India Shipping* [1981] AC 909, 919.

[72] Cf. *Eckersley v Binnie* (1988) 18 Construction Law Reports 1, 77-78 (Bingham, LJ); *Archibald v Byron Shire Council* (2003) 129 Local Government and Environmental Reports of Australia 311, 323 (Sheller, JA); Jacobs, *Commercial Arbitration Law and Practice,* Vol 1B (update 80), [28.109].

[73] Cf. *Bremer Vulkan v South India Shipping* [1981] AC 909, 976; *Imperial Leatherware Co Pty Ltd v Macri & Marcellino Pty Ltd* (1991) 22 NSWLR 653, 662.

[74] *BHP Billiton Limited v Oil Basins Limited* [2006] VSC 402 (Unreported, Hargrave J, 1 November 2006) [21].

differing standards applied as between the majority arbitrators and the minority arbitrator. But in our view, that is not the case. As we read his Honour's observation, it simply emphasised the point that the majority arbitrators (with whose reasons alone his Honour was concerned) were eminent retired judges who had been chosen because of their legal ability. That does not imply that a different or lesser standard should be expected of the third arbitrator. The third arbitrator was an eminent United States oil and gas lawyer and academic who was plainly well qualified to provide reasons of the standard expected of the other two.

Setting aside the award for error of law

The appellant contends in the alternative that, even if there were error in the majority arbitrators' failure to provide sufficient reasons, it did not warrant setting aside the award.

We do not accept that contention. As the judge noted, and as was accepted below, it is not in doubt that an arbitrator's failure to give adequate reasons may amount to error of law on the face of the award. The principle is established by a line of cases which takes as its starting point the statement of Megaw J in *In re Poyser and Mills' Arbitration*[75] concerning s 12 of the *Tribunals and Inquiries Act 1958* (Eng) that: Up to [the enactment of section 12], people's property and other interests might be gravely affected by a decision of some official. The decision might be perfectly right, but the person against whom it was made was left with the real grievance that he was not told why the decision had been made. The purpose of section 12 was to remedy that, and to remedy it in relation to arbitrations under this Act. Parliament provided that reasons shall be given, and in my view that must be read as meaning that proper, adequate reasons must be given. The reasons that are set out must be reasons which will not only be intelligible, but which deal with the substantial points that have been raised. In my view, it is right to consider that statutory provision as being a provision as to the form which the arbitration award shall take. If those reasons do not fairly comply with that which Parliament intended, then that is an error on the face of the award. It is a material error of form.…No one here suggests for a moment actual misconduct on the part of the arbitrator, but it may well be that what has gone wrong here is something which is capable properly of being described as both misconduct and error of law on the face of the award… I do not say that any minor or trivial error, or failure to give reasons in relation to every particular point that has been raised at the hearing, would be sufficient ground for invoking the jurisdiction of this court. I think there must be something substantially wrong or inadequate in

[75] [1964] 2 QB 467, 478.

the reasons that are given in order to enable the jurisdiction of this court to be invoked.

More particularly, it has been held that the requirement for an arbitrator to give reasons under s 29(1)(c) of the *Commercial Arbitration Act 1984* has the effect that an arbitrator's failure to include a statement of proper, adequate reasons, is an error of law on the face of the award within the meaning of s 38(5)(b)(i) of the Act. As Kirby P[76] put it in *Warley Pty Ltd v Adco Constructions Pty Ltd*:[77]

The same obligation of reasoned decisions which falls upon judges is applied by the Act to arbitrators who make awards. They are required by s. 29(1)(c) to include in the award "a statement of the reasons for making the award". This statutory obligation to provide reasons appears to be equivalent to the common law obligation imposed on judicial officers to provide such reasons. In the case of arbitrators, the reasons must be such as the Act envisages.[78]

A failure to give 'reasons' as the Act envisages would amount to an error of law. It would be such as to attract the operation of s 38 of the Act…[79]

The point is reinforced by the New South Wales Court of Appeal's decision in *Promenade Investments Pty Ltd v State of New South Wales,*[80] as follows: In applying s 38, as amended, a construction that would promote the purpose or object underlying the Act must be preferred to a construction that would not promote that purpose or object; s 33 of the *Interpretation Act 1987*… The expression "error of law on the face of the award" is one of a type well-known to courts. The award having been examined the question is whether there is apparent (and such is the denotation of the word "manifest") an error of law. "Manifest error" is an expression sometimes used in reference to reasons given by judges or the approach taken by juries: see, eg, s 107(c)(iii) of the *Supreme Court Act 1970* and the judgments of Kirby P in *Azzopardi v Tasman UEB Industries Ltd* (at 151) and *Otis Elevators Pty Ltd v Zitis* (1986) 5 NSWLR 171 at 181. It is used to indicate something evident or obvious rather than arguable: see generally per McHugh JA in *Larkin v Parole Board* (1987) 10 NSWLR 57 at 70-71. Nothing more is to be learnt from the language used but of course the discretion of the court as to whether or not it will grant leave remains and regard must be had to the requirement of subs (5)(a). The matters referred

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[76] As his Honour then was.

[77] (1992) 8 Building and Construction Law 300.

[78] Ibid 305.

[79] Ibid 309.

[80] (1992) 26 NSWLR 203, 225 (Sheller JA).

to by Lord Diplock in *The Nema* remain important factors in determining whether leave should be given.

Clarke JA, speaking for the New South Wales Court of Appeal[81] in *Friend and Brooker Pty Ltd v Council of the Shire of Eurobodalla*,[82] added further emphasis in a case in which it was contended that the arbitrator's reasons were inadequate because the findings set out were an inadequate foundation for the conclusion reached: My conclusion is that the critical finding by the Arbitrator is equivocal and incapable of supporting either the amount awarded or the total loss for which Mr. Bennett QC opts. On the other hand I do not think it can be said that the finding leads to the consequence that nothing should be awarded. The findings of fact are simply an inadequate foundation for any conclusion.

In the result there is a manifest error of law - in the sense in which that word is used in the *Commercial Arbitration Act 1984*, s 38(5) as discussed in *Promenade Investments Pty Ltd v State of New South Wales* [1991] 26 NSWLR 203, 255 – in that the Arbitrator has failed to find the facts necessary in law to support his conclusion. As a consequence leave to appeal from this part of his Award ought to have been granted by Cole J and the appeal allowed. This Court, which has the powers enjoyed by Cole J (*Supreme Court Act*, s75A(6)) ought therefore, in my opinion, to grant leave to appeal and to allow the appeal. The same approach been followed consistently in this state.[83]

Counsel for the appellant referred to two recent English decisions, *ABB AG v Hochtief Airport GmmbH*[84] and *Benaim (UK) Ltd v Davies Middleton & Davies Ltd (No 2)*[85] as support for the view that an award should not be set aside for manifest error of law on the face of the award unless the error amounts to a 'serious irregularity' and that an insufficiency of reasons ought not be regarded as a serious irregularity for that purpose.

But in our view those authorities do not assist in this context. Each is based on s 68 of the *Commercial Arbitration Act 1996* (Eng) (which significantly restricts the circumstances in which a court is to set aside an arbitral award for error to 'serious irregularity' as defined). There is no such restriction on the power of the court to set aside an award for error of law

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81 Kirby P and Clarke and Sheller JJA.

82 (Unreported, New South Wales Court of Appeal, Kirby P, Clarke and Sheller JJA, 9 November 1993), 9.

83 See, for example, *Energy Brix Australia Corporation Pty Ltd v National Logistics Coordinators (Morwell) Pty Ltd* (2002) 5 VR 353, 368; *Anaconda Operations Pty Ltd v Fluor Australia Pty Ltd* [2003] VSC 275 (Unreported, Victorian Supreme Court, Dodds-Streeton J, 28 July 2003) [31]-[49] and the cases there cited; *Gunns Forest Products Ltd v North Insurances Pty Ltd* (2006) 14 ANZ Ins Cas 61-691.

84 2006] 1 All ER (Comm) 529, [2006] 1 Lloyd's Rep 1.

85 [2005] EWHC 1370 (TCC).

pursuant to s 38 of the *Commercial Arbitration Act 1984* (Vic). A second difference between the *Commercial Arbitration Act 1996* (Eng) and the *Commercial Arbitration Act 1984* (Vic) is that s 70(4) of the former confers on the court an express power to order further reasons and thus by necessary implication excludes from the power to set aside an award for substantial injustice those cases in which the subject defect is constituted solely of a deficiency in reasons.[86] Thirdly, and more generally, as was noted by Lord Steyn in *Lesotho Development v Impregilo SpA*[87] the 1996 English Act has: given English arbitration law an entirely new face, a new policy, and new foundations. The English judicial authorities…have been replaced by the statute as the principal source of law. The influence of foreign and international methods and concepts is apparent in the text and structure of the Act, and has been openly acknowledged as such. Finally, the Act embodies a new balancing of the relationships between parties, advocates, arbitrators and courts which is not only designed to achieve a policy proclaimed within Parliament and outside, but may also have changed their juristic nature.[88]

Turning then to the requirements of s 38(5)(a), we consider that the judge was plainly right to hold as he did[89] that determination of the question of law concerned could substantially affect the rights of the respondents in the sense that, if the majority arbitrators had set out the reasoning which led to their findings and from their findings to their conclusion, it might have appeared that their reasoning was incapable of supporting the conclusion and that the result should have been different.

Other things being equal, it would have been appropriate in this case to remit the matter to the arbitrators for re-determination in accordance with the court's opinion. But, as the judge observed, that was not possible in view of the death of the chairman. In those circumstances, in our view, it was within the proper exercise of discretion for the judge to set aside the award as he did.

Failure to consider and adjudicate upon substantial and serious submissions

What we have said is sufficient to dispose of the appeal. In case the matter goes further, however, it is appropriate that we deal briefly with the appellant's further contention that the judge was wrong in holding that the

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[86] See *Fidelity Management SA v Myriad International Holdings BV* [2005] 2 Lloyd's R 508.

[87] [2006] 1 AC 221, 230 [17].

[88] Citing Lord Mustill and Stewart Boyd QC (*Commercial Arbitration*: 2001 Companion Volume to the Second Edition, preface).

[89] *BHP Billiton Limited & Ors v Oil Basins Limited* [2006] VSC 402 (Unreported, Hargrave J, 1 November 2006) [127].

majority arbitrators were guilty of technical misconduct by reason of their failure to take the respondents' submissions into account.

Counsel for the appellant argued that it is clear from the majority arbitrators' reasons that they rejected the respondents' submissions because the respondents did not establish that 'overriding royalty' was a term of art with the meaning for which they contended. In counsel's submission, in those circumstances it was enough for the majority arbitrators to do as they did, namely, set out the factors which they found to support the plain meaning construction of the expression 'overriding royalty'; have regard to contextual matters; contrast the context of the private mineral holdings in the United States with the context of the Royalty Agreement, including the statutory regime prevailing at the time the agreement was entered into; and find on the evidence before them that 'overriding royalty' does not and never has had one fixed meaning.

We reject those submissions substantially for the reasons we have given. Expert opinion was at the heart of this dispute. The parties put before the arbitrators literally hundreds of pages of competing expert views backed by thousands of pages of texts and authority. The arbitrators having agreed to determine such a dispute were, in our view, bound to undertake an analysis of the expert opinion evidence and the texts and authorities and to come to a conclusion supported by a rationale explanation for their preference. Instead of providing such an explanation, they confined themselves to the statement in paragraph 154 of their reasons, already referred to,[90] to the effect that in 'some respects the evidence of some of the expert witnesses, in particular Judge Simons and Judge Levine, differs from the other' and that 'having read and considered their statements of evidence and heard their oral evidence, where these differences occur we generally prefer the evidence of Judge Simons.' As the judge held, in our view correctly, that does 'not contain any analysis of the contrary expert evidence relied upon by [the appellants] or reasons for rejecting that evidence' and the arbitrators' failure to provide that analysis 'constituted technical misconduct.'[91]

Counsel for the appellant argued that the majority arbitrators were not required to explain why they preferred the Judge Simons' opinion to those of the respondents' experts. They contended that arbitrators as such are not expected to set out what counsel described as 'subsidiary details of that kind' and that it is enough for arbitrators to set out their findings of fact based on the whole of the evidence in the way that the majority did.

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[90] It is set out in full in [0], above.

[91] *BHP Billiton Limited & Ors v Oil Basins Limited* [2006] VSC 402 (Unreported, Hargrave J, 1 November 2006) [131] and [133].

In our view that contention is untenable. For the reasons already given, we consider that, in a case of this kind, it was incumbent on the majority arbitrators to explain how they came to accept the opinion of Judge Simons over the competing opinions of the respondents' experts[92] and to provide an intelligible explanation of why Judge Simons' opinion was accepted in preference to the opinions of Judge Levine, Professor Martin and Mr. McCollam and the authorities on which they relied. That necessitated confronting and dealing with the respondents' substantial arguments as why the opinions of their experts should be preferred. They did not do so. In their submissions before the arbitrators, the respondents advanced ten considerations drawn from the royalty agreement as to why Judge Simon's opinion should be rejected and those points were in addition to arguments based on the Consultancy Agreement (with the latter of which the majority arbitrators did deal very briefly). Those arguments went to the heart of the respondents' case. They devoted eight of the 50 pages comprising their closing written submissions to those points and emphasised them again in final address.[93] Yet, as the judge observed, not one of them is mentioned in the majority arbitrators' reasons.[94]

The appellant contends in the alternative that, even if there were error of law in the majority arbitrators' failure to deal with some of the evidence and submissions on which the respondents relied, the judge was still wrong to hold that it amounted to 'technical misconduct'. Counsel for the appellant submitted that the relevant concept of 'misconduct' is informed by the inclusion in the definition of 'misconduct' in s 4(1) of the Act of 'corruption, fraud, partiality, bias and a breach of the rules of natural justice'. They suggested, as Ipp J put it in *Forsyath NL v Australasian Gold Mines NL*,[95] that 'it is not however, without relevance that it omits any reference to an error of law'.[96] Counsel also called in aid the dictum of Brownie J in *Friend and Brooker Pty Ltd v The Council of the Shire of Eurobodalla,* that it is to be 'doubt[ed] that one can legitimately describe an error of law or a series of errors of law as constituting misconduct for the purposes of s 42.'[97] In counsel's submission, whatever the exact scope of the notion of

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92 *Fletcher Construction Australia Ltd v Lines MacFarlane & Marshall Pty Ltd* (2002) 6 VR 1, 31 [101]-[104] (Charles, Buchanan and Chernov JJA); Jacobs, *Commercial Arbitration: Law and Practice*, Vol 1B (at Update 74), [29.107].

93 Transcript of Proceedings, *BHP Billiton Limited v Oil Basins Limited* (Supreme Court of Victoria, Hargrave J, 18-19 September 2006).

94 *BHP Billiton Limited & Ors v Oil Basins Limited* [2006] VSC 402 (Unreported, Hargrave J, 1 November 2006) [114].

95 (1992) 7 WAR 549.

96 Ibid, 559.

97 (Unreported, Supreme Court of New South Wales, Common Law Division, Brownie J, 20 June 1991), [15].

'technical misconduct' it does not extend to a failure to refer to or deal in reasons with evidence or submissions.

We disagree. The expression 'misconduct' as used in relation to arbitration does not necessarily or indeed often involve moral turpitude on the part of the arbitrator.[98] As was said in *Williams v Wallis and Cox*, [99] 'misconduct' does not really amount to much more than such a mishandling of the arbitration as is likely to amount to some substantial miscarriage of justice.[100] In our view, failure of an arbitrator to deal in his or her reasons with relevant evidence and substantial submissions is a mishandling of the arbitration and thus is 'misconduct' within the meaning of s 42.

We acknowledge that there have been doubts expressed about the point.[101] Significantly, in *Sydney Water Corporation Ltd v Aqua Clear Technology Pty Ltd*,[102] Rolfe J said that, while it has generally been accepted that it is an error of law[103] for an arbitrator to fail to give proper reasons or to fail to address substantial and serious submissions, he had some doubts as to whether the failure to give reasons as required by s 29 or to deal with substantial and serious submissions amounts to technical misconduct. In his Honour's view it was perhaps better thought of as a failure properly to consider the material in the sense of not exposing the reasoning process and, in the course of doing so, indicating to the parties the way in which substantial and serious submissions have been determined so that the parties and the court can consider whether the award is infected with relevant error, namely, manifest error on its face.

With respect, however, we do not share those doubts. It is true that not every error of law committed by an arbitrator will amount to misconduct. To take a simple example, an arbitrator might make a mistake about the

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98 *The Melbourne Harbour Trust Commissioners v Hancock* (1927) 39 CLR 570, 587-588 (Isaacs, J); *Gas & Fuel Corporation of Victoria v Wood Hall Ltd* [1978] VR 385, 391 (Marks, J).

99 [1914] 2 KB 478, 484 (Lush J) and 485 (Aktin J), to which the judge referred.

100 See also *The Melbourne Harbour Trust Commissioners v Hancock* (1937) 39 CLR 570, 588 (Isaacs J): a mistake in procedure which has or may have unjustly prejudiced a party; and *Van Dongen v Cooper* [1967] WAR 143, 146 (Virtue J): 'no reflection on the integrity of the arbitrator'.

101 See Jacobs, *Commercial Arbitration Law and Practice,* Vol 1B (at Update 74) [40.780] and [40.798].

102 (Unreported, Supreme Court of New South Wales, Common Law Division, Rolfe J, 17 December 1996).

103 See, for example, *Pettit v Dunkley* [1971] 1 NSWLR 376; *Dennis Willcox Pty Ltd v Federal Commissioner of Taxation* (1988) 79 ALR 267, 276-7 (Jenkinson J with whom Woodward and Foster JJ agreed); *Kalwy v Secretary, Department of Social Security (No 2)* (1993) 32 ALD 451, 458; *Warley Pty Ltd v Adco Constructions Pty Ltd* (1992) 8 Building and Construction Law 300 and *Chadwick Industries Pty Ltd v Costain Australia Ltd* (Unreported, Supreme Court of New South Wales, Common Law Division, Smart J, 15 February 1988), to which the judge referred.

substantive law of contract. That would be an error of law but it would not be misconduct.[104] It is also true that not every act of misconduct will amount to an error of law (of the kind to which s 38(5) applies). For instance, an arbitrator might so restrict argument or cross-examination as to misconduct the arbitration within the meaning of s 42, but that would not be an error of law within s 38(5). But where, as here, an error of law consists in an arbitrator's failure to include in reasons what the Act requires to be included, it is in our view both logical and appropriate to regard the omission as constituting *technical misconduct* as well as error of law (in the same way that Megaw J did in *In re Poyser and Mills' Arbitration*[105] and McKechnie J did in *Villani v Delstrat Pty Ltd*).[106]

It is suggested in *Jacobs* that the failure of an arbitrator to deal with submissions worthy of serious consideration and seriously advanced would be better thought of as a 'procedural mishap' justifying remission under s 43 than 'misconduct' justifying that the award be set aside under s 42. But, with respect, that distinction will not always be useful. Granted, not every technical irregularity is sufficient to warrant setting aside an award.[107] Indeed, the court will not intervene at all unless it is demonstrated that the misconduct in question may have been productive of 'a substantial miscarriage of justice' (as it was put by Marks J in *Gas & Fuel*[108]) or 'some injustice' (in the sense explained by Lord Donaldson in *King v Thomas McKenna Ltd*[109]). Hence the aphorism that the court will not permit s 43 to be used as a backdoor method for circumventing the statutory restrictions on the court's power to intervene in arbitral proceedings.[110] But if a 'procedural mishap' is productive of some fundamental injustice, in our view it is apt to be described as 'a mishandling of the arbitration … likely to amount to some substantial miscarriage of justice' and, therefore, as 'misconduct'.

Certainly, the setting aside of an award may be viewed as the remedy of last resort and, if it is possible to save the award by remitter for further

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[104] *King v Thomas McKenna Ltd* [1991] 2 QB 480, 491 (Lord Donaldson MR).

[105] [1964] 2 QB 467, 478.

[106] [2002] WASC 112 (Unreported, Supreme Court of Western Australia, McKechnie J, 16 May 2002) [40]-[43].

[107] *Peter Shwarz (Overseas) Pty Ltd v Morton* (2004) 20 BCL 133, 140 [29] (Byrne, J); cf *Anconda Operations Pty Ltd v Fluor Australia Pty Ltd* [2003] VSC 275 (Unreported, Supreme Court of Victoria, Dodds-Streeton J, 28 July 2003) [65].

[108] [1978] VR 385, 392.

[109] [1991] 2 QB 480, 489; *Bovis Lend Lease Pty Ltd v WGE Pty Ltd* [2002] NSWSC 939 (Unreported, New South Wales Supreme Court, Einstein J, 4 October 2002)[31].

[110] *Allgold Foods Pty Ltd v Conagra International (Australia) Pty Ltd* (Unreported, New South Wales Supreme Court, Giles J, 11 July 1990); *Imperial Leatherware Co Pty Ltd v Macri & Marcellino Pty Ltd* (1991) 22 NSWLR 653, 670.

consideration under s 43, a court will ordinarily adopt that course. But the fact that a 'procedural mishap' may in some circumstances be better dealt with under s 43 than 42 does not mean that there are not other cases in which such misconduct should be dealt with under s 42.

Counsel for the appellant argued that there was no injustice sufficient to warrant that the interim award be set aside under s 42, because there was no suggestion that the majority arbitrators' findings[111] were not available on the evidence. In counsel's submission, the respondents are in reality complaining about the factual findings which were made against them – seeking to repeat the arbitration process in the hope that different factual findings might emerge – and that is impermissible.

We do not accept that argument. As has been explained, it is not enough to avoid the possibility of injustice that it may have been open on the evidence to find as the majority arbitrators did. What was required were reasons which demonstrated that the majority arbitrators so found on a rational and otherwise lawful basis after considering and rejecting or discounting the evidence which pointed the other way. As it is, because of the inadequacy of the majority arbitrators' reasons, one cannot exclude the possibility that the majority arbitrators reached their conclusions through failure to consider some part of the evidence or as a result of rejecting or discounting it on an irrational or otherwise unlawful basis. As we have said, for the respondents to be left in the position of not knowing which way it went was in our view a substantial injustice.

If, as we consider to be the case, it was open to the judge to set aside the award under s 38, there was obviously no need to rely on s 42. But, if contrary to our view it was not open to deal with the matter under s 38, we agree with the judge that, in this case, it would have been open to set aside the award under s 42.

Conclusion

In the result, the appeal will be dismissed.

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[111] That 'the term [overriding royalty] does not and never has had one fixed meaning' and was commonly used 'with a range of meanings'. Interim Award, Appeal Book Vol 8, C1959, [182] and [185].

Observations by Doug Jones*

Introduction

The recent Victorian Court of Appeal decision in *Oil Basins Limited v BHP Billiton Limited* [2007] VSCA 255 (*Oil Basins*) upheld the judgement of Hargrave J (*BHP Billiton Ltd v Oil Basins Ltd* [2006] VSC 402) which ordered a matter decided at arbitration be completely reheard by a differently constituted arbitral panel on the basis that:

a) the arbitral panel's reasons were so inadequate that it constituted a manifest error on the face of the award; and

b) there was technical misconduct on the part of the arbitrator in failing to give consideration to significant submissions and evidence.

This case raises the issue of whether, and to what extent, the courts should interfere with arbitral awards. In particular, it supports the assertion that domestic arbitration is becoming too much like litigation to be useful as a means of alternative dispute resolution. It also reinforces the desirability of the UNCITRAL Model Law as adopted in the *International Arbitration Act 1974* (Cth) (*IAA*) over the (domestic) uniform Commercial Arbitration Acts of the Australian States.

Background

Oil Basins and BHP Billiton (together with Esso Resources Pty Ltd and other related Australian entities) were in dispute over royalties for hydrocarbons produced and recovered by BHP off the coast of Victoria. The dispute arose from a royalty agreement struck in 1960 under which the right to an overriding royalty equal to two and half percent of the value of hydrocarbons produced by BHP and its successors within the area was assigned to Oil Basins. As BHP's exploration licence for the area was relinquished in 1979 for commercial reasons and reinstated in 1987, the point in dispute was whether the royalty agreement survived the relinquishment of BHPs title in 1979.

The parties, both domiciled in Australia, entered into an arbitration agreement in May 2004 which was to be conducted in accordance with the *Commercial Arbitration Act 1984* (Vic) (*CAA*). The arbitral panel found for Oil Basins, and BHP subsequently brought proceedings in the Victoria Supreme Court pursuant to sections 38 and 42 of the *CAA*, claiming that

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the arbitral panel's reasons were so inadequate that it constituted both a manifest error on the face of the award as well as technical misconduct by members of the arbitral panel.

The Decision

At first instance, Hargrave J found for BHP on both grounds, ordering the matter be reheard by a new arbitral panel. The reasons of the majority arbitrators were found to be inadequate because of uncertainty due to inconsistencies in reasoning. The majority arbitrators did not identify which evidence was relied upon to reach their decision, or why this evidence was preferred to the substantial body of evidence to the contrary presented by BHP. It was held that the arbitrators were required, and failed, to give intelligible reasons for their rejection of significant evidence and neglected to even refer to certain submissions which were at the heart of the matter.

In respect of section 38(5)(b)(i), the manifest error of law found by Hargrave J was a lack of reasons in that the arbitral panel failed to find the facts necessary in law to support their conclusion. While it is well settled that a lack of reasons in an arbitral award can amount to an error of law,[1] what is more controversial is the standard of reasons required in a domestic award. Hargrave J concluded that, due to the background and experience of the arbitrators (as retired judges of superior courts) and the parties respective counsel and the formality of the proceedings, the standard of reasons required of the arbitrators 'was equivalent to the reasons to be expected from a judge deciding a commercial case'.[2]

On appeal, the Court of Appeal upheld Hargrave J's decision on all issues. They did, however, clarify that it was the complexity and circumstances of the case which dictated the standard of the award rather than the subjective matters to which Hargrave J referred. These subjective matters, said the majority of the Court of Appeal, 'did not dictate the applicable standard, but rather, reflected the nature of the decision'.[3]

In addressing the requirement of reasons generally, the Court of Appeal stated that the standard of the arbitral award depends on the particular circumstances of the case. Should a case turn on a single issue of fact, the arbitrator may only be required to provide 'rudimentary identification of the issues, evidence and reasoning from the evidence to the facts and from the facts to the conclusion'.[4] However, in a complex commercial

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1 *Oil Basins Limited vBHP Billiton Limited* [2007] VSCA 255, 63.

2 *BHP Billiton Limited v Oil Basins Limited* [2006] VSC 402 [23].

3 *Oil Basins Limited vBHP Billiton Limited* [2007] VSCA 255, 54.

4 *Oil Basins Limited vBHP Billiton Limited* [2007] VSCA 255, 57.

arbitration involving reasons and analysis advanced on either side and conflicting expert evidence, such as *Oil Basins*, the arbitrator will likely be required to provide 'an intelligible explanation of why one set of evidence has been preferred over the other; why substantial submissions have been accepted or rejected; and, thus, why the arbitrator prefers one case to the other'.[5] While it is understood that an arbitrator's reasons may not be as skilfully expressed as those of a judge, and therefore should not be construed too critically by a court, an arbitrator is nevertheless required to provide reasons of an appropriate standard when making binding decisions which affect the rights and obligations of the parties to the arbitration.

Rights of Appeal and Judicial Interference in Arbitration

Section 38(4) of the *CAA* allows resort to the Courts only in circumstances where there is a question of law arising out of an award and either all the parties to the arbitration agreement have consented to the appeal or the Supreme Court has granted leave to appeal. In considering whether to grant leave to appeal, essentially the court must be satisfied that there has been a manifest error of law on the face of the otherwise final and binding award.

Prior to the introduction of the *CAA*, there were general rights of appeal from arbitral awards at common law, for errors of law *or fact* on the face of the award. Accordingly, the Act did represent a significant restriction on the rights of appeal. Furthermore, given the tiered approach it appears that Parliament's intention was, save for fairly exceptional circumstances, to uphold the final and binding nature of arbitration.

The issue of whether, and to what extent, the courts should interfere in arbitral awards is the subject of ongoing debate with an emphasis on the balance between fairness and finality. It is argued that, by allowing judicial review of legal issues, the arbitral tribunal has become just another tier in the appeal process.[6] On the other hand, in a domestic environment, where the parties are both Australian entities familiar with the legal system and there is considered to be no "home town" advantage, it has been regarded as satisfactory for the court to have power to review the legal merits of both the process and the outcome. Nonetheless, where a decision such as *Oil Basins* encourages a conservative approach to be taken by arbitrators as to what is required to accord the parties natural justice, the benefits of arbitration may be less prevalent.

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5 *Oil Basins Limited vBHP Billiton Limited* [2007] VSCA 255, 57.

6 C Pudig, 'Domestic Lessons from International Arbitration', 23(3) *The Arbitrator and Mediator* 29.

Has Domestic Arbitration become too much like Litigation?

The often touted advantages of arbitration are said to be its ability to provide:

> *"a speedy and confidential process before a tribunal selected by the parties, to resolve a dispute without recourse to the technicalities often to be found in court litigation. It allows the arbitrator to adopt a procedure which is relevant to the particular dispute being determined."*[7]

It was expected that to gain these benefits, the full rigours of litigation would not be required and some stones would have to be left unturned. Notwithstanding, generally speaking it was intended that such a process would produce a final and binding decision which could be enforced by the parties while remaining cheaper, faster and more flexible than litigation.

The *Oil Basins* decision illustrates the assertion that domestic arbitration is mimicking the more arduous litigious process which it sought to replace and thus is becoming as time consuming and expensive as litigation. Arbitrators of domestic arbitral proceedings must now ensure that they provide sufficient reasons to support each and every conclusion reached, particularly for large and complex arbitrations.

In many instances the problems with domestic arbitration stem from an inability to conduct arbitral proceedings in the advantageous manner envisaged above. A failure to utilise the opportunities afforded by arbitration is often blamed on the legal profession. However, it must also be recognised that once a dispute has commenced the clients too may be far less likely to agree to a less adversarial approach. Accordingly, it is said that it is the arbitrator who must attempt to bring about this change.

In requiring complex arbitral awards to be of the same or similar standard to those of judgements, arbitrators may be forgiven for not taking more innovative approaches. On the other hand, the focus on the standard of reasoning required, based on the complexity of the dispute, represents a balance of the desires of parties to have their argument fairly heard and considered, regardless of the background of the arbitrator. It may also be argued that such a requirement reinforces the robust nature of domestic arbitration in Australia as a mature alternative dispute resolution mechanism based on the bargain of the parties, and perhaps nudges disputes of lesser complexity into the realm of non-binging alternative resolution such as conciliation.

The desirability of UNCITRAL Model Law

As stated above, *Oil Basins* concerned a domestic arbitration, conducted in the state of Victoria in accordance with the *CAA,* between two parties

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7 F Costigan, 'Practical Issues in Domestic Arbitration' 24(2) *The Arbitrator & Mediator* 53, 53.

both domiciled in Australia. In Australia, there is a distinction between domestic arbitration and international arbitration. Matters of international arbitration are governed by the *IAA*, section 16 of which adopts the UNCITRAL Model Law (Model Law). Part II of the *IAA* contains the implementation of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (New York Convention) and Part IV implements the ICSID Convention. Should parties opt-out of the application of the Model Law by express choice in writing (section 22 of the *IAA*), the rules of domestic arbitration will apply. Domestic arbitration is governed by the Commercial Arbitration Act of the state or territory where the arbitration takes place, all of which are largely uniform.

The provisions of the *CAA* in relation to rights of appeal differ to those of the Model Law. The Model Law does not provide for a right to challenge an award due to a manifest error of law or misconduct by the arbitral panel, nor does it explicitly provide for a right to challenge an award on the basis of inadequate reasons. It may be possible for an appeal to be brought for inadequate reasons under the Model Law if the court hearing the appeal were to adopt a very wide approach to Article 34 section (2)(b)(ii) which provides for discretion to set aside the award if it is in conflict with public policy. Alternatively, an appeal may arguably be brought pursuant to Article 34 section (2)(a)(iv) which allows for an arbitral award to be set aside if the arbitral procedure was not in accordance with the agreement of the parties or was not in accordance with the Model Law which, at Article 31 section (2), requires the arbitral award to state the reasons upon which it is based. However, the likelihood of an applicants success in being granted leave to appeal on such basis remains untested and is thus uncertain.

Conclusion

While *Oil Basins* is certainly a significant decision, it should be remembered that its effect is limited to domestic arbitration and it only provides binding authority for the state of Victoria. Nevertheless, parties wishing to ensure the finality of their arbitral award must be careful in drafting their arbitration clauses that they elect to arbitrate under the *IAA* which implements the Model Law, rather than the *CAA* with its broader rights of appeal. Furthermore, in order for arbitrators under the *CAA* to minimise challenges to their awards, they must be careful to provide adequate reasons for each and every conclusion they reach by:

a) stating the relevant facts;

b) explaining why each issue of fact is resolved in a particular way; and

c) stating what conclusion is reached on each question of law and how that conclusion was reached.